ANNUAL REPORT

INTRODUCTION

For more than 15 years, the GASB has been working to create a new financial reporting model for state and local governments. In June 1999, the board finally completed its work with the release of GASB Statement No. 34 – Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments. Without a doubt, GASB 34 represents the most important single change in the history of accounting and financial reporting for state and local governments.

The term "financial reporting model" has been used in recent years to describe the basic framework used for external financial reporting. Needless to say, the "financial reporting model" historically used by state and local governments differs substantially from that used by private-sector businesses. The principal differences between these two reporting models are fund accounting; the measurement focus and basis of accounting (MFBA); and budgetary reporting.

GASB felt that the current method in which state and local government handled its financial reporting was not meeting the needs of the users of the financial statements. Based on GASB research and analysis, it was determined that a new reporting model could be designed to assist the various classifications of the users of the financial statements. The new reporting model has various "sections" required which, for the current discussion, we will breakdown into three broad categories:

A. Management's Discussion and Analysis (MD & A)
B. Government-wide Financial Statements
C. Fund Financial Statements (including notes to the financial statements)

The three sections all have their purpose or focus group of readers of the financial statements.

The MD & A section appeals to that group of financial statement users that prefer a broad narrative, with summarized financial information, summary of financial picture of the entity. They prefer to read a description of what has happened during the fiscal year, rather than look at and analyze financial information.

The government-wide financial statements provide a more aggregated presentation of the financial information of the state or local government on changes in economic resource basis. This type of financial statement user is someone who wants a broad perspective of the overall financial picture of the state or local government.

The fund financial statements provide the detailed information of the state or local government's major funds. This category of financial statements is very similar to the current reporting model used by state and local governments. This type of financial statement user is someone who wants or needs to analyze specific major areas of the state or local government.

The basic financial records will require very little modification. The manner in which the financial information is presented on the financial statements is what has changed.

GOVERNMENT-WIDE REPORTING VERSUS FUND FINANCIAL STATEMENTS

As noted previously, governments traditionally have prepared combined financial statements that focus on fund types rather than on the government as a whole. The new financial reporting model will by no means abandon traditional fund accounting for state or local governments. It will for the first time, however, require that consolidated, government-wide financial statements accompany the more traditional fund based financial reports. Although the focus of the new government-wide financial statements will be on the government as a whole, those statements will still distinguish governmental activities (governmental funds) from business-type activities (enterprise funds).

The major differences between the government-wide financial statements and the fund financial statements will be discussed in detail in following sections, however, a summary of some of the major differences or requirements of each are summarized below:

Government-wide Financial Statements:

- Required Financial Statements: Statement of Net Position & Statement of Activities
- Changes in Economic Resources MFBA – Accrual Basis of Accounting
- Exclusion or limitation on the use of fiduciary funds
- Introduction of permanent funds
- Introduction of private-purpose trust funds
- Exclusion or elimination of the reporting of internal service funds
- Expanded mandatory use of enterprise funds
- Limitation on the voluntary use of enterprise funds

Fund Financial Statements:

- GASB 34 has left the basic accounting and financial reporting substantially unchanged. Nevertheless, it does introduce a certain number of changes and clarifications to existing guidance

- Required Financial Statements:
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Governmental Funds –	Balance Sheet
	Statement of Revenues, Expenditures and Changes in Fund Balances
Proprietary Funds –	Statement of Net Position
	Statement of Revenues, Expenses and Changes in Net Position
	Cash Flow Statement
Fiduciary Funds –	Statement of Net Position
	Statement of Changes in Net Position

- Focus of financial reporting will shift from a fund type reporting to major individual funds reporting
- Creation of a fifth governmental fund type to be known as permanent funds
- Elimination of "Account Groups"
- Elimination of capital maintenance focus (contributed capital) for proprietary funds

CHANGES IN BUDGETARY REPORTING

In the past, all local governments have included a budget-to-actual comparison for the General Fund, special revenue funds, and capital projects funds as one of their basic financial statements. The primary purpose of such statements was to demonstrate legal compliance.

GASB 34 significantly modifies the manner in which budgetary data will be presented in the annual financial statements as follows:

- Budgetary schedules will now present the original budget adopted as well as all changes (contingent transfers and supplements to the budget) separately.
- Budgetary comparisons used to be required for all fund types adopting budgets but now will be required for the General Fund and major special revenue funds only. (in most cases schools will report all funds therefore, every fund will be a major fund)
- Budgetary comparisons used to be reported in an aggregated form by fund type. If you had seven special revenue funds, you reported one budgetary statement for all special revenue funds combined. Under GASB 34, separate reporting of budgetary information will be required for the General Fund AND for each major individual special revenue fund. No budgetary reporting will be required for nonmajor special revenue funds. In addition, no budgetary comparison reporting will be required for any capital projects funds.
- Under GASB 34, budgetary comparison schedules will be reported as required supplementary information instead of as a basic financial statement as is done now. The budgetary comparison schedules will follow the notes to the financial statements.
- A separate column to report the variance between the final budget and actual amounts is no longer required by GASB but is encouraged. We have decided that presentation of such a column is desirable for the budgetary schedules to have any useful value.
- The notes to the financial statements must still disclose any material excess of expenditures over appropriations in individual funds.

A reconciliation of Budget to GAAP Basis should be prepared for those counties that report encumbrances.

GASB 34 defines special items as “Significant transactions or other events within the control of management that are either unusual in nature or infrequent in occurrence.” Extraordinary items are defined as “Transactions or other events that are both unusual in nature and infrequent in occurrence.” Special items should be reported separately in the statement of activities and the statement of revenues, expenditures, and changes in fund balances just before extraordinary items, if any. Extraordinary items are then reported separately following special items. These items are reported separately from, but in the same manner as, general revenues at the bottom of the statement of activities to arrive at the all-inclusive change in net position for the period.

Significant transactions or other events that are either unusual or infrequent but that are not within the control of management should be separately identified with the appropriate revenue or expenditure category directly on the statement of revenues, expenditures, and changes in fund balances OR they should be disclosed in the notes to the financial statements.

CLASSIFIED FINANCIAL STATEMENT PRESENTATION

Under the current financial reporting model, proprietary funds often do not report a classified statement of position (i.e., statements of net position that distinguish current assets and liabilities from noncurrent assets and liabilities). The new financial reporting model will require that proprietary funds always present a classified statement of net position.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

STATEMENTS REQUIRED - GASB 34 mandates the presentation of two basic government-wide financial statements:

A. The Statement of Net Position

B. The Statement of Activities

The scope of the new government-wide financial statements is to include all governmental and business-type activities, but NOT fiduciary activities. That means that Trust and Agency Funds will not be included on the government-wide statements. Governmental activities and business-type activities are to be reported in separate columns, with a consolidated total column being presented for the primary government. To the right of the total column will be a column for reporting component units such as the Housing and Redevelopment Commissions.

STATEMENT OF NET POSITION – Although GASB 34 allows for a variety of layouts, local governments in South Dakota will use the balance sheet format for the government-wide statement of net position. The balance sheet format provides a "balancing effect" whereby total assets should equal total liabilities and net position. This format is similar to that used on Exhibit one in past years.

What was previously referred to as the "equity" section should now be called "net position". Net position follow the following formula:

Total Assets – Total Liabilities = Net Position

Although GASB 34 allows for alternative methods of presentation, South Dakota counties should report the accounts on the statement of net position in the order of their relative liquidity. For example, cash is more liquid than inventories, inventories are more liquid than capital assets, etc… GASB 34 prescribes that net position be classified into the following three categories:

1. Net investment in capital assets
2. Restricted net position
3. Unrestricted net position

The first category should reflect the cost of capital assets, adjusted for any accumulated depreciation, as well as for any debt associated with their acquisition, construction or improvement.

The "restricted net position" category is designed to reflect net position that are subject to restrictions that are beyond the government's control. Qualifying restrictions for this purpose include the following:

a. Restrictions that are externally imposed (e.g., by creditors, grantors or contributors)

b. Restrictions imposed by law through constitutional provisions or enabling legislation.

Most of the net position of special revenue funds would constitute "restricted net position". For example, the assets of the Sales Tax and 911 Funds are restricted by statute.

The enabling legislation part of the definition covers situations when the government passes a law that gives them the ability to levy a tax or otherwise raise revenues, and in that law, the government commits to using those resources for a particular purpose. That arrangement is tantamount to a legally binding agreement between the government and the taxpayers establishing limitations on how those funds can be used. The government generally cannot unilaterally decide to do something else with those resources. This is different from situations when a government passes a law that says existing resources are restricted to a specific purpose or "earmarks" a portion of an existing revenue source. (Capital outlay accumulations) In that situation the government does not obtain funds under restrictive conditions; thus, the limitations imposed indicate designations, not restrictions.

Any remaining balance of net position is to be reported as "unrestricted net position." GASB 34 does not permit the reporting of designations on the face of the government-wide statement of net position.

POLICY FOR USE OF RESTRICTED RESOURCES – Under the new governmental financial reporting model, net position is broken into three categories. In practice, it is common for governments to have the option of using either restricted or unrestricted resources to liquidate a particular expense. Accordingly, governments must select a flow assumption to determine in such cases which assets (restricted or unrestricted) are being used first, when both restricted and unrestricted assets are available for the same purpose. GASB 34 requires that this flow assumption (policy) be disclosed in the notes to the financial statements.

For example, within a Capital Projects Fund there may be assets that are restricted because the derived from a bond issue and there may be unrestricted local dollars committed to the project. Each school district should adopt a policy to stipulate whether restricted on unrestricted dollars (or a percentage of each) will be used first to pay for the capital project.

INTERNAL SERVICE FUNDS – As a general rule, the assets and liabilities of internal service funds will be eliminated, for the most part, in the process of consolidation. Any remaining balances that are not eliminated normally will be reported in the "governmental activities" column of the statement of net position (rather than the "business-type activities" column), even though internal service funds are proprietary funds rather than governmental funds. The GASB reasons that this treatment is appropriate because the activities accounted for in internal service funds are usually more governmental than business-type in nature. (self insurance coverage for employees of governmental activities). Conversely, in situations where enterprise funds are, in fact, the predominant participants in internal service fund activities, residual balances should be reported in the "business-type activities" column of the government-wide statement of net position.

A key goal of consolidating internal service funds is to eliminate duplication. The revenues and expenses between the internal service fund and the entity fund it serves should not double up on reporting the revenues and expenses. For example, the charge to a General Fund function for health insurance and the payment of a claim from the internal service fund would essentially double up on reporting the same expenditure.

For purposes of consolidation, it is presumed that an internal service fund operates on a strictly break-even basis within the primary government. Accordingly, any profit on internal activity is presumed to indicate that participating functions have been overcharged. Likewise, any loss on internal activity is presumed to indicate that participating functions have been undercharged. Therefore, consolidation is accomplished by reducing (if there is a profit) or increasing (if there is a loss) the amount of expense reported in the participating functions.

Assume the following facts at year end for a particular self-insurance internal service fund:

Charges for services	$800,000
Cost of services	700,000

Increase in net position	$100,000
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Further assume that this internal service fund provides goods and services to individual functions at the following levels:

General Government	30%	$ 30,000
Public Safety	20%	20,000
Public Works	50%	50,000
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Totals	100%	$100,000
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Since the internal service fund operated at a profit for the year the profit should be posted to the functions noted above during the year end "reconciliation process".

CONSOLIDATION – The new statement requires that the total column for the primary government presented on the government-wide statement of net position be fully consolidated. That is to say balances (of interfund loans, etc) between "governmental activities" and "business-type activities" are to be eliminated from the total column.

Rather than reporting "due to" and "due from" accounts, GASB suggests the use of an account called internal balances. The internal balances account will be reported as an asset account. Any "due from" amounts are to be reported as a positive internal balance amount. A "due to" amount would be reported as a negative internal balance amount. If you add across to arrive at the total internal balance for the primary government, the balance would be zero.

Bear in mind that the preceding internal balances approach should only be used for interfund activity between governmental and business-type activities. If there are interfund accounts solely within the governmental activities column, then those amounts should be eliminated. For example, an interfund loan from the Sales Tax Fund to the General Fund would be eliminated because both of those funds are reported within the governmental activities column.

GOVERNMENT-WIDE STATEMENT OF ACTIVITIES – The other basic government-wide financial statement in the new financial reporting model is the statement of activities. The format of this new statement differs profoundly from the formats now used to report the activities of governmental, proprietary and fiduciary funds.

Governments, unlike businesses, do not ordinarily provide services as a means to an end (i.e., profit), but rather as an end in themselves. In principle then, governments make their financial plans by first determining the types and levels of services they need or wish to provide, and then determining how these services are to be financed. Some services are partially financed from sources outside the government itself (i.e., charges for services, grants and contributions). In that case, a government will naturally wish to isolate and focus its attention on the portion of the cost of services that it will need to finance from its own resources. The "net program expense" format mandated by GASB 34 is designed precisely to reflect this unique governmental perspective.

PROGRAM REVENUES - Under the net program cost format, program expenses are netted against program revenues. Program revenues include the following:

- amounts received from those who purchase, use or directly benefit from a program; (rubble sites, swimming pools, airports, etc) Charges for services should also include revenues from licenses and permits (they directly benefit by paying for the privilege), liquor licenses and building permits.

- amounts received from parties outside the school district's citizenry (e.g., grants and contributions) that are restricted to one or more specific programs.

- earnings on investments that are legally restricted for a specific program

Charges for services should be reported separately from grants and contributions. Likewise, operating grants and contributions should be reported separately from capital grants and contributions. A grant or contribution that may be used for either operating or capital purposes should be treated as an operating grant or contribution.

Fines and forfeitures should be reported as program revenues. As a rule, charges for services should be reported as a program revenue of the function that generates them. In the case of fines and forfeits, one function (e.g., police, health department) often will issue a citation for an alleged legal or regulatory infraction, which is then subject to adjudication by the courts. Another way to look at reporting fines with the police department is that if there were no police department there would be no fines.

To qualify as program revenue, a grant or contribution must be restricted to one or more specific functions. In the case of multi-purpose grants, the amount associated with each particular function must be specified either in the grant contract or in the underlying application form. However, multi-purpose grants of the reimbursement variety always will meet the test of restriction because such a grant, for accounting and financial reporting purposes, is only considered to occur when all eligibility requirements have been met (including the incurrence of qualifying expenditures in a particular function).

GENERAL REVENUES – All revenues that do not qualify as program revenues should be reported as general revenues. General revenues are to be presented immediately below the totals for "net (expense) revenue and changes in net position."

All taxes, even those that are levied for a specific purpose, are general revenues and should be reported by type of tax –for example, property taxes and sales taxes. All other nontax revenues that do not meet the criteria to be reported as program revenues should also be reported as general revenues.

General revenues are not always discretionary revenues. For example, even though motor vehicle revenues cannot be used for other than "road" purposes, they are still general revenues. Program revenues derive directly from the program itself or from parties outside the school district's taxpayers or citizenry, as a whole; they reduce the net cost of the function to be financed from the government's general revenues. Motor vehicle revenues do not derive directly from the public works program itself, but rather they are restricted general revenues provided by law to finance the cost of specific programs.

The gain or loss on the sale of a capital asset should be netted into general revenues as a miscellaneous revenue. Consideration should also be given to reporting the sale of a capital asset as a special or extraordinary item if it fits the relevant criteria.

REPORTING EXPENSES BY FUNCTION – GASB 34 mandates that governments report their activities at least by function. That is to say, in the case of governmental activities, the level of detail required is that currently found in the governmental fund operating statement (e.g., "general government," "public safety," "public works"). For business-type activities, each segment (enterprise fund) is considered to be a function. (water, sewer, liquor, electric).

Each function should report all expenses that are clearly identified with it (i.e., direct expenses). Direct expenses include <u>depreciation</u> related to capital assets that can be specifically identified with a given function. This means that equipment should be sorted by function with the respective depreciation expense coded to each related function.

<u>Interest</u> on long-term debt is NOT a direct expense and should be reported as a separate function.

<u>Depreciation expense</u> that does not qualify as a direct cost (primarily buildings) should be reported as a separate line item in its own right. If a separate line is used, it should be made clear on the face of the statement that only unallocated amounts are included in that line.

<u>Depreciation on infrastructure</u> assets should be reported as a direct expense of the function normally associated with the acquisition and maintenance of infrastructure, or alternatively, as a separate line item.

PERMANENT FUND CONTRIBUTIONS – Contributions to permanent fund principal are to be reported as a separate revenue line in the general revenue section of the government-wide statement of activities. (cemetery perpetual care fund contributions)

GOVERNMENT-WIDE CONCLUSION – Perhaps the most striking feature of the new financial reporting model is the introduction of government-wide reporting. The government-wide statement of net position will feature, among other things, the reporting of assets and liabilities previously reported in account groups, the reporting of infrastructure assets and a new classification structure for net position. The government-wide statement of activities will focus readers' attention on the net expense of a government's various functions, with a new line item for "special items" and the elimination of the traditional distinction between types of transfer accounts.

Depreciation expense will play a key role in the new government-wide statement of activities, consistent with the GASB's adoption of the economic resources measurement focus and the accrual basis of accounting for government-wide reporting.

FUND FINANCIAL STATEMENTS

GOVERNMENTAL FUND FINANCIAL STATEMENTS

Governmental funds, with their traditional measurement focus on current financial resources and their use of the modified accrual basis of accounting, continue to have an important role to play in ensuring and demonstrating fiscal (and sometimes legal) accountability. One interesting change is that under GASB Statement No. 34, a budgetary operating statement for governmental funds will not be required to be presented as a basic financial statement. Instead, the budgetary comparison statement will be presented as "Required Supplementary Information."

Fund financial statements are the most familiar part of the financial reporting "house." Yet, even this part has undergone some remodeling. A new fund type has been added – Permanent Funds, and a wall has been moved – the budgetary comparison statement. Conspicuously absent from the fund financial statements are the General Capital Assets and General Long-term Debt Account Group columns, whose information will only appear in the government-wide financial statements, from now on.

STATEMENTS REQUIRED

The required fund financial statements remain similar between the old and the new reporting models.

For Governmental Funds, the required financial statements are:

The Governmental Fund Balance Sheet; and,
The Governmental Fund Statement of Revenues, Expenditures and Changes in Fund Balance.

MAJOR FUND REPORTING

While the basic fund financial statements remain relatively unchanged, there has been a significant shift from reporting combined financial information in separate columns by fund type, to reporting individual "major" funds in separate columns. The traditional combined financial statements presented aggregated information by fund type. Under the new reporting model, fund-based financial reporting will focus on "major individual funds" rather than on fund types. By definition, the General Fund will always be considered to be a "major fund." Other major governmental funds will be those that meet the following criteria:

An individual fund that reports at least 10 percent of any of the following:

a. total governmental fund assets, or
b. total governmental fund liabilities, or
c. total governmental fund revenues, or

total governmental fund expenditures, and

at least 5 percent of any of the following:

a. total assets for governmental and enterprise funds, or
b. total liabilities for governmental and enterprise funds, or

total revenues for governmental and enterprise funds, or
total expenditures/expenses for governmental and enterprise funds,

Both the 10 percent and 5 percent thresholds must be exceeded by the SAME preceeding element in order to be a major fund.

Nonmajor funds may be reported singly, or combined into a "nonmajor governmental funds" column, and a "nonmajor proprietary funds" column. If an entity has only a few governmental funds, each fund may be presented in its own column.

GOVERNMENTAL FUNDS BALANCE SHEET

Governmental funds will continue to report a traditional balance sheet (assets = liabilities plus fund equity) as their basic statement of position. Assets and liabilities will be presented in the order of liquidity, or nearness to cash. For example, accounts receivable are more likely to be converted to cash sooner than property, plant and equipment, and accounts payable are more likely to be paid with cash before the non-current portion of a long-term debt issue. Some of the key features of the remodeled governmental balance sheet are as follows:

Information will now be reported; by major individual fund rather than by fund type, and the presentation of a total column is now mandatory.

Governmental funds will continue to exclude capital assets and most long-term liabilities.

The difference between assets and liabilities will continue to be reported as “fund balance,” which in turn is divided into nonspendable, restricted, committed, assigned and unassigned.

A reconciliation to explain the difference between the numbers reported on the governmental fund balance sheet and the numbers reported for “governmental activities” in the government-wide statement of net position must be presented in an accompanying schedule immediately following the balance sheet. Most of the differences result from differences in measurement focus and basis of accounting between the governmental fund financial statements and the government-wide financial statements. Another cause of difference is the fact that the residual balances of internal service funds normally are reported as part of governmental activities in the government-wide financial statements, even though internal service funds themselves are accounted for as proprietary funds rather than governmental funds.

GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE

Governmental funds will continue to report a statement of revenues, expenditures and changes in fund balances. This statement will be presented at the same level of detail currently found in Exhibit III (revenues reported by major source, and expenditures reported by sub-function/department). Some of the key features of this revised statement are as follows:

The basic format used must be “revenues minus expenditures, plus or minus other financing sources and uses, plus beginning fund balance equals ending fund balance.” This is the format that has typically been used in South Dakota for many years.

Again, information is reported by individual major fund rather than by fund type. The reporting of a total column is mandatory.

Distinguishing between operating and residual equity transfers is no longer required; instead, both will be treated simply as “transfers” and reported as other financing sources and uses, as appropriate.

“Special items” (transactions that are under management’s control, but that are either unusual in nature, OR infrequent in occurrence – but not both) are reported as a separate line item following other financing sources and uses. Similar treatment is afforded “extraordinary items” (transactions that are not under management’s control, and that are both unusual in nature, and infrequent in occurrence). A separate line item would follow any “special items.”

A reconciliation to explain the difference between the numbers reported on the governmental fund statement of revenues, expenditures and changes in fund balance and the numbers reported for "governmental activities" in the government-wide statement of activities must be presented in an accompanying schedule immediately following the statement.

DEBT PROCEEDS

Underwriter fees are frequently withheld from the amount of debt issue proceeds transmitted to the issuer. Under current GAAP, many governments simply report the net proceeds (cash received) as an "Other Financing Source" (usually in a capital projects fund). Under GASB Statement 34, an "Other Financing Source" equal to the face amount of the debt will be reported in the governmental fund receiving the debt proceeds (usually a capital projects fund) in a caption such as "Bonds issued", or "Long-term notes issued." Any issuance costs paid out of debt proceeds, such as underwriter fees, should be reported as expenditures.

For example, assume a government issued $5 million in General Obligation Building bonds, at a stated interest rate of 3%, dated September 1, 200X and maturing twenty-five years after that date. Assume bond counsel and underwriter fees are $150,000, and the bonds were actually sold on November 1, 200X at 95. In General Journal format, the following entries would be made:

CAPITAL PROJECT FUND: dr. cr.

Cash	4,625,000	
Expenditures – Debt Issuance Costs	150,000	
OFU – Discount on Bonds	250,000	
OFS – Bonds Issued		5,000,000
Due to Debt Service Fund		25,000

DEBT SERVICE FUND:

Due from Capital Projects Fund	25,000	
Accrued Interest Payable–Bonds		25,000

GENERAL LONG-TERM LIABILITIES SELF BALANCING ACCOUNTS:

Amount to be provided for payment of Bonds	5,000,000	
Bonds Payable		5,000,000

To record sale of G.O. Building Bonds at 95
plus interest accrued to date of sale.

DEBT REFUNDINGS

Under GASB Statement No. 34, all refundings that result in the defeasance or redemption of debt should be reported in the same way. Amounts of the new debt issued and placed into escrow, or used to retire debt should be reported as other financing sources or uses, as applicable.

SALES OF CAPITAL ASSETS

The receipt of proceeds from the sale of capital assets (General Capital Assets) should be reported as an "Other Financing Source – Proceeds from Sale of Assets." The sale of a capital asset may be a "special item" if it meets those conditions.

Sales of capital assets accounted for in an enterprise fund will usually generate either a gain or a loss on the sale that will be reported on the operating statement of the enterprise fund. If, in compliance with

SDCL 6-13-8, the governing board chooses to credit the proceeds from the sale of property recorded in an enterprise fund to the General Fund, the gain or loss from the sale of the property should be recognized in the enterprise fund that owned the property, and a transfer made to the General Fund for the amount of the proceeds from the sale.

CONCLUSION – GOVERNMENTAL FUNDS

GASB Statement No. 34 essentially retains the traditional accounting and financial reporting for governmental funds. The governmental fund financial statements are likely to be the most familiar piece of the new financial reporting model. However, some important changes have occurred, including the introduction of major fund reporting, the introduction of a new fund type (i.e., permanent funds) and the elimination of the requirement to include budgetary comparisons as part of the basic financial statements. In addition, GASB has clarified gaap related to the proper treatment of current debt refundings, the receipt of debt proceeds, and the receipt of proceeds from the sale of capital assets.

PROPRIETARY FUND FINANCIAL STATEMENTS

Under GASB Statement No. 34, governments will continue to report two types of proprietary funds (i.e., enterprise and internal service funds). Both types of proprietary funds will be reported, as they are today, using the economic resources measurement focus and the accrual basis of accounting. These are the same measurement focus and basis of accounting as will be applied in the preparation of the government-wide financial statements.

Under GASB Statement No. 34, the use of an enterprise fund normally is restricted to activities "for which a fee is charged to external users for goods or services." Enterprise funds <u>must</u> be established whenever any of the following criteria are met:

Debt backed solely by fees and charges. If debt has been issued that is backed solely by fees and charges, then an enterprise fund must be used to account for the activity. This "sole backing" criterion would encompass debt that is secured, in part, by a portion of the debt proceeds themselves (i.e., "restricted funds"), but not debt that is also secondarily secured by the full faith and credit of the government.

Legal requirement to recover cost. An enterprise fund must be used if the cost of providing services for an activity (including capital costs such as depreciation or debt service) must legally be recovered through fees or charges.

Policy decision to recover cost. The use of an enterprise fund is necessary if it is the government's policy to establish fees or charges for an activity that are designed to recover the cost of providing services (including capital costs such as depreciation or debt service).

Under GASB Statement No. 34, the focus of the basic financial statements will shift from fund types to individual major funds. In other words, a separate column for each individual major enterprise fund will be presented in the proprietary fund financial statements. Internal service funds, though, will always be presented in the aggregate in the fund financial statements.

Major individual enterprise funds will be those that meet the following criteria:

An individual fund that reports at least 10 percent of any of the following:
a. total enterprise fund assets, or
total enterprise fund liabilities, or
total enterprise fund revenues, or
total enterprise fund expenses, and

at least 5 percent of any of the following:
total assets for governmental and enterprise funds, or
total liabilities for governmental and enterprise funds, or
total revenues for governmental and enterprise funds, or
total expenditures/expenses for governmental and enterprise funds.

Nonmajor funds may be reported singly, or combined into a "nonmajor governmental funds" column, and a "nonmajor proprietary funds" column. If an entity on has a few proprietary funds, each fund may be presented in its own column.

Traditionally, proprietary funds, like private-sector businesses, have taken a "capital maintenance" approach to preparing their financial statements. This approach carefully distinguished the portion of net position provided by "investors" , from the portion of net position generated from operations. Under the new reporting model, however, proprietary fund financial statements will focus on limitations on the use of assets rather than on their source. Proprietary fund net position will, instead, be classified as net investment in capital assets, as restricted net position, and as unrestricted net position.

For Proprietary Funds, the required financial statements are:

The Statement of Net Position,
The Statement of Revenues, Expenses and Changes in Net Position; and,
The Statement of Cash Flows

PROPRIETARY FUNDS STATEMENT OF POSITION

Under the new reporting model, proprietary funds will focus on net position rather than on the degree to which they have preserved capital. The current balance sheet format will be retained, with the following terminology change: the appropriate "net position" terminology and categories shall be used. Additionally, a "classified" presentation of assets and liabilities in the statement of position is now required. A classified presentation of assets and liabilities is now required.

PROPRIETARY FUNDS STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION

The key features of the proprietary fund operating statement are as follows:

Each major enterprise fund will be presented in its own column, with a total column for all enterprise funds.

Internal service funds will be aggregated in a single column, presenting all internal service funds separately from enterprise funds to underscore the connection between the enterprise funds and the business-type activities reported in the government-wide financial statements.

Contributions of capital will be reported as a separate line item in the statement of activities following "non-operating revenues (expenses)."

PROPRIETARY FUNDS STATEMENT OF CASH FLOWS

Major individual enterprise funds will be presented in separate columns on this statement, too, with all internal service funds aggregated into a single column. A total column for all enterprise funds must be included. Proprietary funds are currently required to present a statement of cash flows.   GASB Statement No. 9, allows governments to use either the direct method or the indirect method to report cash flows from operating activities, but recommends the direct method. The direct method presents information on individual types of cash flows (e.g., "receipts from customers," "payments to suppliers," "payments to employees"), whereas the indirect method simply furnishes a reconciliation of the differences that exist between "cash flows from operating activities" and "operating income." GASB Statement No. 34 amends GASB Statement No. 9 to require the use of the direct method in all cases, with the appropriate reconciliation prepared using the indirect method. When the direct method is used, certain operating cash flows must be reported as separate line items.

The principal advantage of the direct method is that it shows operating cash receipts and payments. That is, it is more consistent with the objective of a statement of cash flows—to provide information about cash receipts and cash payments—than the indirect method, which does not report operating cash receipts and payments. Supporters of the direct method contend that knowledge of the specific sources of operating cash receipts and the purposes for which operating cash payments were made in past periods is useful in estimating future operating cash flows. Furthermore, information about the amounts of major classes of operating cash receipts and payments is more useful than information only about the arithmetic sum (the net cash flow from operating activities)

Under the new governmental financial reporting model, governments will continue to report two types of proprietary funds; enterprise funds and internal service funds.

The main purpose of the statement of cash flows is to provide relevant information about the cash received and cash disbursed by a proprietary fund during the fiscal year.

Corollary purposes are to aid the reader in:

Assessing the fund's ability to generate positive net cash flows.
Assessing the fund's ability to meet its obligations, its ability to support Governmental Funds' operations, and its need for future financing.
Assessing the reasons for differences between net income and the associated cash receipts and disbursements.
Assessing the effects on a fund's financial position of both its cash and non-cash investing and financing transactions during a period.

Cash not only includes cash on hand and demand deposits, and short-term time deposits (passbook savings), but also includes savings certificates and highly liquid investments with terms to maturity of three months (90 to 92 days) or less when acquired. However, a security reaching its final three months to maturity, but which was acquired more that three months before maturity does not get reclassified as a cash equivalent.

Restricted cash balances, usually classified as non-current assets, are included in the cash and cash equivalents definition regardless of the restrictions on their use.

The notes to the financial statements should include a definition of cash and cash equivalents applied to the statement of cash flows.

Preparation:
In the preparation of the statement of cash flows, GASB requires four cash flow categories:
Cash flows from operating activities
Cash flows from noncapital financing activities
Cash flows from capital and related financing activities
Cash flows from investing activities

Operating activities: The proprietary fund cash flows from operating activities classification generally incorporates only the cash effects of transactions and events that enter into operating income rather than net income. Consequently, the cash effects associated with nonoperating revenues and expenses such as interest revenue and interest expense are not included in cash flows from operating activities. The GASB Codification states that: Operating activities generally result from providing services and producing and delivering goods, and include all transactions and other events that are not defined as capital and related financing, noncapital financing, or investing activities….

Noncapital financing activities and Capital and related financing activities: Noncapital financing activities and capital and related financing activities are distinguished by whether the cash flow is clearly attributable to the financing of capital assets (i.e., capital assets) acquisition, construction, or improvement. Cash flows from issuing (or repaying) debt, interest payments, interfund transfers from other funds, and certain

other transactions will be classified as capital and related financing activities if clearly attributable to capital asset financing. Otherwise, they are classified as noncapital financing
activities. For example, cash received from issuing bonds that are clearly issued for the explicit purpose of financing construction of a capital asset is reported as cash flows from capital and related financing activities. Cash payments of interest or principal on those bonds also will be classified as capital and related financing activities. The cash effects of issuing or servicing all other debt issuances (not clearly attributable to capital asset financing) would be noncapital financing activities.

Investing activities: Investing activities include (a) making and collecting most loans, (b) making or disposing of investments in debt or equity instruments, and (c) the related interest and dividends received.

The table below summarizes the common classifications of the typical cash flows of proprietary funds. This table is not intended to be comprehensive. Many transactions and situations are beyond the scope of this summary.

Cash Flow Classification Summary
Cash Flows from Operating Activities
Cash received from sales of goods and services
Cash paid for materials used in providing services or manufacturing goods for resale
Cash paid to suppliers for other goods or services
Cash paid to employees for services
Cash received or paid resulting from quasi-external transactions *
Cash received from other funds for reimbursement of operating transactions
Cash payments for taxes
Cash received or paid from grants for specific activities that are part of grantor governments' operating activities
Other cash flows that are not properly reported in the other classifications

* Quasi-external Transactions – transactions that would be treated as revenues or expenses if they involved organizations external to the governmental unit. Examples would be services provided by a department financed from one fund to a department financed from another fund.
These services should be accounted for as revenues or expenses as appropriate in the funds involved.

Cash Flows from Noncapital Financing Activities
Cash received from (or paid to repay) borrowing not clearly attributable to capital assets
Cash paid for interest on those borrowings
Cash received from operating grants not included in operating activities
Cash paid for grants or subsidies to other governments that are not included in operating activities
Cash paid for transfers out and for interfund reimbursements not included in operating activities
Cash received from transfers not clearly made for capital asset purposes

Cash Flows from Capital and Related Financing Activities
Cash received from (or paid to repay) borrowings clearly attributable to capital assets
Cash paid for interest on those borrowings
Cash received from capital grants
Cash paid or received from acquisition or disposal of capital assets
Cash received from transfers from other funds for the specific purpose of financing capital assets
Cash received from special assessments or taxes levied to finance capital assets

Cash Flows from Investing Activities
Cash paid or received for the acquisition or disposal of investments in debt or equity securities
Cash paid or received from loans made to others
Cash received from interest and dividends

NONCASH INVESTING, CAPITAL, AND RELATED FINANCING ACTIVITIES

Information about all investing, capital, and financing activities of a governmental enterprise during a period that affect recognized assets or liabilities but do not result in cash receipts or cash payments in the period should be reported. This information, should be presented on the same page as the statement of cash flows. Examples of noncash transactions are acquiring assets by assuming directly related liabilities, obtaining an asset by entering into a capital lease; and exchanging noncash assets or liabilities for other noncash assets or liabilities.

INDIRECTLY DETERMINING DIRECT-METHOD CASH FLOWS

GASB Statement No. 9, states that under the direct method, governments should, at a minimum, separately report these classes of operating cash receipts and payments.

Cash receipts from customers
Cash receipts from quasi-external operating transactions with other funds
Other operating cash receipts, if any
Cash payments to other suppliers of goods or services
Cash payments to employees for services
Cash payments for quasi-external operating transactions with other funds, including payments in lieu of taxes
Other operating cash payments, if any

Items a, d, and e generally will account for the majority of cash flows from operating activities and, depending on the particular accounting system, may require substantial time and effort to accumulate actual amounts. As mentioned in footnote 82 to paragraph 440 in the Basis for Conclusions of Statement 34, however, acceptable approximations of these amounts may be determined indirectly.

Essentially, the accrual-basis revenues and expenses are adjusted for changes in related accounts receivable and payable. The attached calculations demonstrate how to indirectly determine the direct-method cash flows for cash receipts from customers and for cash paid to employees and suppliers.

Operating revenue is adjusted to determine “cash received from customers” by (1) adding the beginning customer accounts receivable balance to account for cash collected on prior years’ sales and (2) deducting the end-of-the-year customer accounts receivable balance to adjust for the cash not collected from this year’s sales.

Salaries and benefits expense is adjusted to determine “cash paid to employees” by (1) adding the beginning payroll-related accruals to recognize cash that was paid out this year for last year’s payroll expenses and (2) deducting the ending payroll-related accruals to account for the cash that will be paid next year for payroll expenses this year.

Total operating expenses, excluding salaries and employee benefits, and depreciation (an allocation), are adjusted to determine the “cash paid to suppliers” by adding the beginning accounts payable balance and deducting the ending accounts payable balance.

PROPRIETARY FUNDS CONCLUSION

The measurement focus and basis of accounting for proprietary funds has remained basically unchanged. Total enterprise fund amounts appearing in the fund financial statements normally will require little; if any, adjusting when carried to the government-wide financial statements.

FIDUCIARY FUND FINANCIAL STATEMENTS

Under GASB Statement No. 34, all fiduciary funds, except agency funds, will report the same two basic financial statements. The required financial statements are:

The Statement of Net Position; and,
The Statement of Changes in Net Position.

Agency funds will only report the statement of net position because of their purely custodial nature.

Fiduciary funds are never to be considered major funds. Instead, fiduciary fund financial statements will present aggregated information by fund type (i.e., pension trust funds, investment trust funds, private-purpose trust funds and agency funds).

RECONCILING FROM FUND STATEMENTS TO ENTITY WIDE FINANCIAL STATEMENTS

CONVERTING FROM MODIFIED ACCRUAL BASIS TO ACCRUAL BASIS -
The accounting records for governmental funds are generally established by fund and are maintained on a day-to-day basis using the modified accrual basis of accounting. Adjustments are necessary to convert governmental fund financial statement totals prepared using the modified accrual basis of accounting to the government-wide financial statement amounts which, must be presented on the accrual basis of accounting.

PREPARATION AND PLACEMENT OF RECONCILIATION

To convert the fund financial statements from the modified accrual basis of accounting to the accrual basis of accounting a reconciliation must be prepared and presented with the basic financial statements.

The reconciliation explains adjustments made to total fund balance on the governmental funds balance sheet to arrive at total net position on the government-wide statement of net position. The reconciliation also explains adjustments made to the net change in fund balances on the statement of revenues, expenditures, and changes in fund balances of the governmental funds to arrive at the change in net position on the government-wide statement of activities.

The reconciliation shall be included with the basic financial statements in an accompanying schedule. The schedule should be considered a continuation of the fund financial statement; therefore, the schedule should be on the page immediately following the statement it supports. Presenting the reconciliation on a separate page allows extra room for explanations.

RECONCILIATION WORKSHEET

A reconciliation worksheet should be prepared to help in converting governmental fund financial statement amounts reported on the modified accrual basis of accounting to government-wide financial statement amounts reported on the accrual basis of accounting. This worksheet will not only help in keeping the financial statements in balance but, will provide adjustment explanations for audit purposes, and help in preparing the reconciliation presented as part of the basic financial statements.

The worksheet should consist of four columns. The first column would represent fund financial statement amounts by individual account. The next two columns would represent debit and credit columns. The adjustment amounts or reconciling items would be reflected in these columns. The fourth column would reflect government-wide statement amounts; the result of taking the fund statement amounts and either adding or subtracting debit and/or credit adjustments. One should be mindful of the fact that a debit and/or credit adjustment on the statement of net position worksheet may result in a corresponding adjustment on the statement of activities. Explanations for the debit and credit adjustments should be reflected on the worksheet. We also recommend a notation be made, off to the right of the worksheet, explaining how government-wide totals are reported on the statement of activities.

CONVERTING FROM THE MODIFIED ACCRUAL BASIS OF ACCOUNTING TO THE ACCRUAL BASIS OF ACCOUNTING - CONSIDERATIONS

Balance sheet / Statement of Net Position Considerations

- Property taxes and other receivables offset with deferred revenues under the modified accrual basis of accounting in the fund statements may be revenues on the government-wide statements under the accrual basis of accounting.

- Capital assets used in governmental activities are not financial resources and therefore are not reported as assets in governmental funds. Capital asset expenditures in the fund financial statements, are reported as assets on the government-wide statements, and depreciated (expensed) over their useful lives. Sales of capital assets result in removing the cost of the capital asset and accumulated depreciation, resulting in a gain or loss on the sale on the government-wide statements.

- Long-term debt is not reported on the fund statements but on the government-wide statements. However, the current portion is reported on both statements.

Statement of Revenues, Expenditures and Changes in Fund Balances / Statement of Activities Considerations

- Deferred revenues under the modified accrual basis of accounting may be revenues on the government-wide statements under the accrual basis of accounting.

- Depreciation expense not reported in the fund financial statements normally must be allocated to the various expense functions of governmental activities on the government-wide statement of activities. Sales of capital assets may result in a gain or loss in the government-wide statement, where in the fund statement revenue equals the cash recognized from the sale.

- The reporting of long-term debt in the government-wide financial statements results in the reduction of expenditures on the fund financial statements that relate to the annual installment payment.

RECONCILIATION FOR A LEASE-PURCHASE

Although not illustrated on the enclosed financial package, an additional reconciling item between the fund financial statements and the government-wide financial statements could be the presence of a lease-purchase. The fund financial statements under the modified accrual basis of accounting would record the lease-purchase as follows:

Capital Outlay Expenditures	XXXXX	
Other Financing Sources		XXXXX

The government-wide financial statements under the full accrual basis of accounting would instead expense the asset by way of depreciation and also record the debt directly within the governmental activities column. The fund financial Statements would need the following adjustment to bring them up to full accrual:

Other Financing Source	XXXXX	
Capital Outlay Expenditure		XXXXX

The capital asset and long-term debt results of this transaction would also be recognized when the reconciliation postings are performed for all of the General Capital Assets and General Long-term Liabilities.